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No. 71-308

Sup. Ct. U. S.
FILED

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In the Supreme Court of the United States

OCTOBER TERM, 1972

UNITED STATES OF AMERICA, PETITIONER

v.

MARIAN A. BYRUM, EXECUTRIX UNDER THE LAST
WILL AND TESTAMENT OF MILLIKEN C. BYRUM,
DECEASED

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE SIXTH CIRCUIT

PETITION FOR REHEARING

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PETITION FOR REHEARING

Pursuant to Rule 58 of the Rules of this Court, the petitioner, the United States of America, respectfully, and reluctantly, petitions the Court for a rehearing of its decision in this case. It is constrained to do so because the opinion of the Court heavily qualifies, if, indeed, it does not overrule *sub silentio*, prior decisions of the Court that have stood for years as unquestioned authorities with reference to the estate tax.

The decision not only substantially compromises the estate tax by permitting owners of the shares of family or other closely held corporations to retain control during life and, at the same time, to avoid the tax.¹ It also restricts, by its reasoning, what heretofore has been regarded as within the clear reach of the tax. And it might be construed to foreclose consideration of at least one important question not heretofore presented to the Court, not fully presented in this case, and not necessarily involved in the decision herein.

The Court sets forth in Part I of its opinion its decision relating to the Government's Section 2036(a) (2) arguments (Op. 18-19):

We conclude that Byrum did not have an unconstrained *de facto* power to regulate the flow of dividends to the trust, much less the "right" to designate who was to enjoy the income from trust property. * * *

We find no merit to the Government's contention that Byrum's *de facto* "control," subject as it was to the economic and legal constraints set forth above, was tantamount to the right to design-

¹ The implications of this decision have been quickly recognized by the tax bar. On July 17, 1972, *Lawyer's Weekly Report*, p. 106, hailed the decision as a "Sweeping Taxpayer Victory," commenting that: "The new case charts a safe way the major owner can give all or part of his stock in trust to his family, while still retaining virtual control over his company, without having the gift taxed in his estate." See also *The Kiplinger Tax Letter*, June 30, 1972, p. 3: "Owners of closely held firms get a new way to beat estate tax * * *. Sounds almost too good to be true, but Supreme Court gives its blessing."

nate the persons who shall enjoy trust income, specified by § 2036(a) (2).

As grounds for rehearing, the petitioner sets forth, in brief form, the following:

1. Neither the statute, the regulations, nor the previous decisions of this Court require that the right or power "to designate the persons who shall possess or enjoy the property or the income therefrom" be unconstrained or unqualified either factually or legally.

Section 2036(a) includes in the gross estate property transferred "by trust or otherwise" under which the decedent has retained the right in question "either alone or in conjunction with any person." Treasury Regulations on Estate Tax (1954 Code) § 20.2036-1(b) (3) (26 C.F.R.) provides:

With respect to such a power, it is immaterial (i) whether the power was exercisable alone or only in conjunction with another person or persons, whether or not having an adverse interest; (ii) in what capacity the power was exercisable by the decedent or by another person or persons in conjunction with the decedent * * *.

The Regulations are in accord with prior decisions of this Court. The Court has held that a "right" or "power" exercisable by the decedent only in conjunction with a beneficiary having a substantial interest adverse to the exercise of the power (*Helvering v. City Bank Farmers Trust Co.*, 296 U.S. 85), or by the decedent as trustee only in conjunction with co-trustees (*United States v. O'Malley*, 383 U.S. 627), is nevertheless such a power or right as to bring the

property transferred within the gross estate of the decedent. In the first case, the factual constraints upon the power or right reserved to the decedent are obvious. They are indeed so substantial that the Court in *Reinecke v. Northern Trust Co.*, 278 U.S. 339, 346, had held that the right to revoke under such limitations was without significance for the practical purposes of the tax. But under a later and different statutory provision, the Court held otherwise in the *City Bank* case. In the *O'Malley* case, in which the decedent could exercise the right only in his capacity as trustee, and only in conjunction with co-trustees, the factual and legal restraints upon the decedent and upon his co-trustees were greater and more striking than the restraints that the Court discusses in this case (Op. 12-15, 17-18). Here the decedent reserved the right to vote the transferred stock in his individual capacity, that is, to vote as he pleased and without any restriction or restraint except such as might be implied by law if he became a director of the corporations. The Court's apparent conclusion that the right of the decedent must be (Op. 18) entirely "unconstrained" in all events is inconsistent with the statute, the regulations, and its prior decisions. See particularly, *Commissioner v. Estate of Church*, 335 U.S. 632, 645.

The great majority of estate tax cases under Sections 2036 and 2038 involve transfers in trust. But the statute covers transfers in trust "or otherwise." The corporate mechanism is highly flexible and, with the exercise of imagination and skill, can be employed to achieve results more commonly obtained by the use of the trust device. For example, a decedent who has

transferred the common stock of a corporation but who has created and retained an issue of cumulative preferred stock, reinforced by an appropriate sinking fund provision calling for periodic retirement of the preferred stock, will have effectively retained for his life the income from the corporate property if he has made a roughly accurate estimate of his expectancy and of corporate income. Making appropriate allowance for a margin of error, he can be confident that the income from the corporate property will be payable to him for a "period which does not in fact end before his death." A decedent who, as here, retains during his life the voting control of a corporation—whether control be considered as a question of fact or of legal definition—will have effectively retained control of the flow of income therefrom even though he may have done so, not alone, but in conjunction with others who, subject ultimately to his pleasure, hold positions as directors. The fiduciary and other restraints upon him and them are no more rigorous or exacting than the similar restraints upon the co-trustees in *O'Malley*.

To dismiss the opinion in *Commissioner v. Sunnen*, 333 U.S. 591, as "a personal income tax case" (Op. 14, fn. 14) diminishes its accuracy and relevance as a description and analysis of the significance of corporate control. Furthermore, we would here reiterate that Byrum reserved control of the transferred stock in a nonfiduciary capacity.² It has long been recog-

² See Restatement of Trusts 2d, § 185, comment c., p. 396, as follows:

It is a question of interpretation whether a power reserved to the settlor to control the trustee in disposing of

nized that in these circumstances the grantor of a trust should be treated as the owner of the transferred stock for income tax purposes.³ See *Helvering v. Fuller*, 310 U.S. 69, 72, 76; Internal Revenue Code of 1954, Sec. 675; Treasury Regulations on Income Tax (1954 Code), § 1.675-1. It seems inconceivable that Congress intended to draw a distinction between income and estate taxes in this regard.

The Court's decision will put a high premium upon the use of the corporate mechanism to achieve and retain controls (be they designated rights or powers) that have heretofore brought liability for estate taxes

and making investments is a power for the benefit of the beneficiaries of the trust generally or for the benefit of the settlor alone or for the benefit of both the beneficiaries generally and of the settlor. A circumstance tending to show that it was for the benefit of the settlor alone would be that he had retained one-half of the shares of a corporation of which he had placed the other half in the trust, because that would tend to show that his purpose was to protect his interest in the shares which he had retained.

³ It is significant that the accumulated earnings tax, imposed by Sections 531-535 of the Internal Revenue Code of 1954 upon corporations accumulating earnings beyond the reasonable needs of the business in order to avoid the income tax with respect to their stockholders, rarely applies to publicly held corporations; and the fact that control is held by a single stockholder or group of stockholders is relevant in determining whether there has been a motive of tax avoidance. Thus, the code and the courts generally recognize that the principal stockholder of a close corporation may be expected to control the dividend policy of the corporation. See, e.g., *Golconda Mining Corp. v. Commissioner*, 58 T.C. No. 13.

if achieved through the mechanism of a trust. It is difficult to believe that the Congress intended such rewards for the utilization of corporate sophistication and skill.

2. It is not necessary that there be income from the transferred property to bring Section 2036(a) into operation.

The Court (Op. 14-17) discusses the vicissitudes of corporate life and the many factors that may make income unavailable—the “economic * * * constraints” referred to (Op. 19) in the concluding paragraph of Part I of its opinion. But there is never complete assurance that securities transferred in trust will be productive of income, and the operation of Section 2036(a) is not dependent upon the fact of income. In a case such as *O'Malley*, the transferor with a right to add income to principal may, if there is income, have to take into account many financial and economic factors in deciding whether to retain income in the trust or to distribute it. But the statute operates if the transferor retains the right to decide with respect to such income as there may be, and whether decision is easy or difficult, completely free or constrained by investment needs or opportunities. The statute operates because the transferor retained for himself during his life, and did not give to others, the right or power to make the decisions with respect to the treatment of income, whether he anticipated that those decisions should be based upon purely personal considerations, or perhaps a delicate amalgam of personal and economic or financial considerations. The Court's dis-

cussion of the uncertainties of income, and of the factors influencing its use, does not, therefore, touch upon the factors made significant by the statute.

3. The Congress has defined the type of conduct that results in estate tax consequences, and has done so in a fashion different from that which prevailed under the Revenue Act of 1921.

The Court refers (Op. 7-8) to *Reinecke v. Northern Trust Co.*, 278 U.S. 339, as indicating that a settlor's retention of broad powers of management does not necessarily subject an *inter vivos* trust to the federal estate tax. The Court also refers (Op. 9) to possible reliance upon that decision, and indicates (Op. 10) that Congress rather than the Court is equipped to act when a principle of taxation requires re-examination.

The Congress did re-examine the principles upon which *Reinecke v. Northern Trust Co.* was decided. It did so under dramatic circumstances in a single day by the Joint Resolution of March 3, 1931, c. 454, 46 Stat. 1516, and perfected its re-examination by Section 803(a) of the Revenue Act of 1932, c. 209, 47 Stat. 169, 279, as set forth in *Hassett v. Welch*, 303 U.S. 303, 307-311. The result of that re-examination was what is now Section 2036(a). As this Court has at least twice stated, the result of that re-examination was the legislative abandonment of the principles upon which *Reinecke v. Northern Trust Co.* was decided.

Reinecke v. Northern Trust Co. arose under Section 402(c) of the Revenue Act of 1921, c. 136, 42

Stat. 227, 278. As the opinion of the Court clearly discloses (278 U.S. 339, 346-347), the Court held that the reserved powers of management of the trusts did not bring them into the gross estate because Section 402(c) as it then was written was construed to eliminate from the gross estate property of which the owner had made an effective transfer of title.⁴

The principles upon which *Reinecke v. Northern Trust Co.* was decided were long ago re-examined by the Congress and legislatively rendered obsolete. Reliance upon them would surely have been misplaced for the past forty years. Indeed this Court's decisions have not indicated that reliance upon the *status quo* of the estate tax could profitably enter into estate planning. Reliance may be an important fac-

⁴ *McCormick v. Burnet*, 283 U.S. 784, and *Helvering v. Duke*, 290 U.S. 591, to which the Court refers (Op. 8, fn. 5) as following *Reinecke v. Northern Trust Co.*, arose under the same statutory provision. See *Duke v. Commissioner*, 23 B.T.A. 1104, for a statement of the issues in that case. But *McCormick v. Burnet* was one of three cases decided March 2, 1931, that resulted in the vigorous and dramatic Congressional response embodied in the Joint Resolution of March 3, 1931, *supra*. See *Commissioner v. Estate of Church*, 335 U.S. 632, 637-640. It would be difficult to conclude that the legislative response left unchanged for the future either the result in *McCormick v. Burnet* or the principles of *Reinecke v. Northern Trust Co.* that it approved and followed. Twice subsequently, when taxpayers have invoked *Reinecke v. Northern Trust Co.* under an amended statute, this Court has rejected their arguments with the statement that the principles of Section 402(c) of the Revenue Act of 1921 were no longer controlling. *Porter v. Commissioner*, 288 U.S. 436, 442; *Helvering v. City Bank Farmers Trust Co.*, 296 U.S. 85, 87-88.

tor in a legal system where voluntary action is being considered. But death is inescapable, and, unless Congress has otherwise provided, the Court has usually applied death taxes effective at the time of death, at least where some element of control continued, whatever the statutory provisions at the time of a transfer. See, e.g., *United States v. Jacobs*, 306 U.S. 363; *Porter v. Commissioner*, 288 U.S. 436.

4. The Court may well have foreclosed consideration of an important question not presented as involved in this case.

The decedent in this case, in addition to reserving voting power over corporations he controlled before he made the transfers in question, reserved the power to approve trust investments and reinvestments. He also reserved the right to remove the trustee and to designate another corporate trustee.

In its petition for certiorari and in its original brief the government supported its assessment of estate taxes on the basis of Byrum's continuing voting control over the corporations involved, and his veto power over disposition of those shares of stock. It did not otherwise bring into the case Byrum's control of investments generally. That issue was interjected by the brief of *Amici* in their effort to maintain that *Reinecke v. Northern Trust Co.* was controlling. In its reply brief, the government (pp. 2-4) made brief answer, but insisted (pp. 4-5) that that issue had no essential bearing on the case.

The issue of the significance of investment control is an important one, though not here necessarily in-

volved. The Court (Op. 8 and fn. 6, 9 *et seq.*), by its approval of *Estate of King v. Commissioner*, 37 T.C. 973, and similar decisions in the lower courts, has cast serious doubt on further consideration of the issue.

Every substantial investor and every investment counselor knows that one may invest for income, or for growth, or for a mixture of the two. Mutual funds, for example, are frequently designated either as income funds or as growth funds. The grantor of a trust who has retained control over investments is free to make the same choice that other investors can make, and thereby to exercise control over income available to life beneficiaries, or to seek growth available only ultimately to remaindermen. That is the same choice that the grantor in *United States v. O'Malley* retained, though he retained it by virtue of a different mechanism. Even if the right is given to the grantor as trustee, a broadly drawn trust instrument will leave his choice substantially unrestrained within limits that will rarely chafe.

It would be remarkable if courts were unable to know, and if the Commissioner of Internal Revenue were prohibited from knowing, what every investor and investment counselor knows. It would be particularly unfortunate if the Court has decided a question of this importance not presented in the petition for certiorari, not fully briefed, and, we believe, not necessary for decision of the case. If the Court believes that investment control is necessarily involved in this case, it would appear that decision might appropri-

ately be deferred until after there has been opportunity for complete briefing and consideration more clearly directed to that important question.

CONCLUSION

For the reasons stated, the petition for rehearing should be granted.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.

JULY 1972.

CERTIFICATE

It is hereby certified that this Petition for Rehearing is presented in good faith and not for delay.

ERWIN N. GRISWOLD
Solicitor General

